We did a call with the CFO of Century **Plyboards India Ltd (CPBI IN Equity, $270mn mkt cap, $1.9mn DVT)** yesterday and I think it is good business with low capex requirement, high ROEs, margin improvement and good sales growth on account of improvement in housing market and GST implementation. However, stock at 11.5xFY16PER seems fairly valued..

Let me know if you need a call with the CFO or anyone else in the management.

Business Overview: The company is mainly in the business of selling plywood and laminates, with these 2 segments contributing ~ 72% and 18% respectively of total sales in FY14. They also have a Container Freight Station (CFS) which contributes 6% of total revenue. Plywood and Laminates have different raw materials used in their production, but the customer profile is very similar.

- **Plywood business (72% of revenue):** The industry size is Rs150bn/annum, with 70% of the share with unorganised players. Out of Rs45bn with the organised players – Century Ply and Greenply have 25% each, with the balance with regional organised players (ex. Uniply in South India). This is a duopoly market as the 3rd largest player has just 3% of the organised market share. Century has a capacity of 210,000 CBM (cubic metre) of plywood in India and has veneer capacity of 24,000CBD in Myanmar. The raw material for this is teak wood – for the

- **Laminate business (18% of revenue):** This is what is popularly known as Sunmica in India, after the company Sun which manufactured the first branded laminate. Century is the 3rd largest player in the organised laminate market. It has capacity of 4.8mn sheets/yr currently – recently increased from 2 lines of 1.2mn/yr to 4 lines of 1.2mn/yr. Greenply, its competitor has 9 lines of 1.2mn/yr which amounts to 10.8mt capacity. EBITDA margin in this business collapsed in FY14 as the increase in capacity was not accompanies by an increase in sales, dragging EBITDA margin in this business from 13% to 8%.

- **Container Freight Station Services (6% of revenue):** Runs two container freight stations at Kolkata port with total capacity of 150k TEUs out of which 1/3rd was utilized in FY14

Demand Drivers:

- **Exposure to housing market:** 90% of plywood and laminate sales ofCentury is to households, with only 10% of sales going to commercial projects. Hence, any boost to housing will lead to good demand for the company. The cost of plywood as a %age of total investment on interiors has come down from 50% few years back to 20% now. As it is not a significant portion of the interiors cost, consumer is not cutting corners here.

- **Move from unorganised to organised:** Plywood market has grown at the rate of 10-12% in value terms in last few years vs the organised players growing at the rate of 25%. 10 years back organised players were just 10% of the total market and are now at 30% of the total market. Few reasons why this shift is happening and is expected to continue in future – company expects 25-30% growth in organised vs industry growth at 10-11% in future.

    - **Consumers are getting brand conscious**, this is what we have seen in several other segments including paints and jewellery

    - Till 2005 excise duty was 16% and there was no VAT (sales tax of 10% was applicable). This created a 26% tax differential which organised players had to pay over what unorganised players were paying. The tax differential came down in 2005 when excise duty was cut from 16% to 8% and VAT was introduced (VAT credit could be availed by distributors). 4 years back excise duty was increased to 12%, but the tax differential over unorganised is now 5-6% (taking into account Modvat credit).

    - The company **expects move from unorganised to organised will gain traction as and when GST comes in**. The unorganised players are currently not paying excise duty because of clandestine billing. This will change once GST comes in and there is a single tax structure.

- **Increase in distribution network**: Century has 33 marketing offices and 5000 dealers (direct 500 exclusive dealers) as of now. They plan to increase the dealer network at the rate of 30% every year – amounting to 1500 new dealers getting added every year. The aim is to be in any city which has more than 1lakh of population. They have expanded to smaller cities with a new brand 'Sainik Ply' which is 15-20% cheaper than their flagship brand 'Century'. The response from the smaller cities has been encouraging. They make lower 200-300bp lower margins on Sainik brand.

Raw Material Challenges: Company uses timber to make plywood - timber log is peeled to make veneer first which is then reeled and cut into standard size. Veneer is glued together – alternate layers are placed horizontally and vertically to make the ply board stronger. It can have anywhere between 4-14 layer of veneer depending on thickness of the ply board. The top and bottom layers are called *face veneer* and the middle layer is called *core veneer. Face veneer* is made from mature timber (50-100yr old trees) which is imported from Myanmar and *core veneer* is made from agro- forestry timber which is grown as a crop (4-6yrs crop cycle) in India and several other countries. 10% of total raw material is *face veneer* , so for every 100 CBM of plywood almost 10CBD of face veneer is required.

- Availability of raw material for core veneer is not a problem at all, however mature timber which was coming from Myanmar and was used as *face* *veneer*has seen supply issues. From 1st **April 2014 Myanmar has banned export of raw timber**. Since this rule was announced in Sep'13 most of the companies have built good inventory of raw timbre in India. According to the new rule, export from Myanmar is allowed only after processing.

- **Century's has timber peeling capacity in Myanmar of 24000 CBM and hence it is able to procure cheap timbre** as it meets the value added requirement. Since timbre prices have fallen from $700/t to $600-650/t post this ban, it is working better for Century as it is buying cheap timbre and processing it to veneer (cost of veneer is $100/ CBM).

- Currently the **company has close to 5-6months of inventory in India**, so it is selling veneer from Myanmar and capturing the increase in conversion margin which this ban has created. However, this is just for the short term. Once the inventory is over they will import veneer from their Myanmar unit to supply to their factories in India. Their manufacturing capacity of 240,000 CBD is enough to meet their current requirement. They have however also submitted a proposal to Myanmar government to increase capacity to 48000CBD which will involve Rs0.1bn of capex (already has land and building so very low capex required)

- Company is also exploring South Africa as a source for veneer to avoid dependency on Myanmar.

- For laminates the raw material is paper, they procure kraft from companies like ITC for the base layer and import design paper from Italy and other European countries for the top layer. Raw material is not an issue at all in the laminate business.

Capex Requirements: Plywood and laminates are **asset light business and do not require heavy investment**. This reflects in high variable cost the company has - 74% of the total cost is VC (62% raw material and 12% is labour cost). At company level, the reported asset turnover is ~5.6x with sales of Rs13bn with total fixed asset of just ~Rs2.3bn. This is the reason for ROCE being as high as 19% in the company. They have 6 manufacturing facilities in India in Haryana (North), Tamil Nadu (South), West Bengal (East), Assam (North-east), Gujarat (West) and Uttarakhand (Central) and one in Myanmar. They do not have any major capex plans for plywood and laminates in next 2 years. Even in the CFS business there is no capex requirement as the utilization is at just 33% currently.

Forex : This is the **key RISK** which the company faces. Since they do not hedge and have $40mn of forex loan, any depreciation of INR will hurt them adversely. They has Rs0.44bn of forex loss in FY14 – Rs0.13bn shown as segmental expenditure, Rs0.27bn in borrowing cost and Rs0.035bn as un-allocable expenditure.

Working Capital: Business has 2 months of debtor days on an average and 3 months of raw material inventory days. Inventory had gone up to 4 months as they procured timbre to prepare for ban of exports from Myanmar. They expect debtor days to remain at 2months but inventory days should go down to 2.5 months as their own unit in Myanmar will mean lower requirement to maintain raw material inventory. Finished goods inventory is usually just at 15 days.

Promoter Holding & pledged shares: Total promoter holding of 74.46% with Mr Sajjan Bhajanka holding 26.71%, Mr. Sanjay Agarwal - 26.54%, Mr Vishnu Khemani - 8.59%, Mr. Prem Bhajanka - 6.24% and Mr. H.P. Agarwal - 6.38%. Promoters in last 1 year have increased share from 73% to 74.46%. 6.3% of shares are pledged as of Mar'14 against the loan taken from DBS to build the Container Freight Station (CFS). Since the land for CFS is owned by the Union government, promoters had to pledge their shares to provide as security against the loan.

No dilution: do not plan to raise any equity in future – as the company expects to generate FCF of Rs1.1bn in FY15 and will have no major capex requirement. They will mostly use the FCF to pay down their short term debt.

STOCK VIEW: We do not cover the company, but based on company's guidance of 25% revenue growth next 2 years FY16 revenue could be Rs20bn, they are guiding for EBITDA margin of 14% (the current level excluding forex loss) and PAT margin could be ~7%, leading to ~Rs1.4bn of PAT in FY16. On these numbers, it is currently trading at ~11.5xFY16 PER, which seems fairly valued. The upside can come if the company can increase its PAT margins further or sees higher growth on account of GST. With ROE of ~23%, dividend yield of 1.4% and long term debt/equity of 0.41x (net debt/equity of 1.6x) we think it is a good quality company.